

# Preparing Your Company's IP for Due Diligence

By Dan Hart

**THE SUCCESS AND SURVIVAL** of many companies hinges on attracting funding or establishing partnerships that provide needed revenue and facilitate the further development of company technology.

Whether yours is an early-stage company seeking its first round of financing, a more mature company seeking follow-on funding, a later-stage company contemplating an IPO, or a company seeking a potential partner, the prospective investor, underwriter or partner will conduct due diligence to ensure that it's making a safe investment.

In addition to the analysis of the business model, potential market and quality of leadership, the due diligence process will include an evaluation of the company's patent position. While such an evaluation may be particularly important to early-stage companies whose primary asset is intellectual property, it's an important component of the due diligence process for later-stage companies, as well.

Thus, it is critical that your company is properly prepared before the due diligence process begins. What follows are some of the important considerations when undertaking that preparation.

- **ENSURE THAT THE COMPANY'S INTELLECTUAL PROPERTY IS ATTRACTIVE.**

The overall intellectual property analysis generally begins with an evaluation of the company's own intellectual property. The company's patent claims determine the extent to which it can preclude competitors

from making, using, or selling technology within the company's field of business.

Therefore a prospective investor or partner will thoroughly review the claims in the company's issued patents and pending patent applications, in order to assess whether they offer enough protection to prevent competitors from entering the company's market and whether they actually cover the products which the company is commercializing or intends to commercialize.

While broad claims will prevent competitors from entering your company's market, they are more susceptible to invalidation by prior publications or activities which may come to light during litigation or during examination of the patent applications at the United States Patent and Trademark Office.

Claims of intermediate scope carry a lower risk of invalidation, but they also erect less of an entry barrier. Narrower claims protect your company's specific commercial products from exploitation by competitors, but they may leave alternative approaches open to competitors.

In order to reduce the risk involved in investing in the company, the party conducting the due diligence inquiry will want the patent portfolio to contain claims of varying scope. But in addition to assessing the scope of protection, the analysis of your patent

portfolio will assess whether it covers the company's technology from a variety of angles. For example, in addition to being reviewed to determine whether they cover the company's products themselves, your patents will be reviewed to determine whether they cover methods of making or using the products, and for any advantageous technical features associated with them.

Again, protecting various aspects of your company's technology provides enhanced protection against invalidating prior art and erects a greater entry barrier to competitors.

A limited patent portfolio may cause a prospective investor or partner to terminate negotiations, so it is important for your company to have considered all the above factors and to have developed an extensive network of patents and patent applications prior to entering due diligence.

Corporate counsel and business development personnel should be sufficiently familiar with the company's patent portfolio to ensure that discussions with prospective investors or partners commence at a time when the company's patent portfolio is adequately prepared for due diligence.

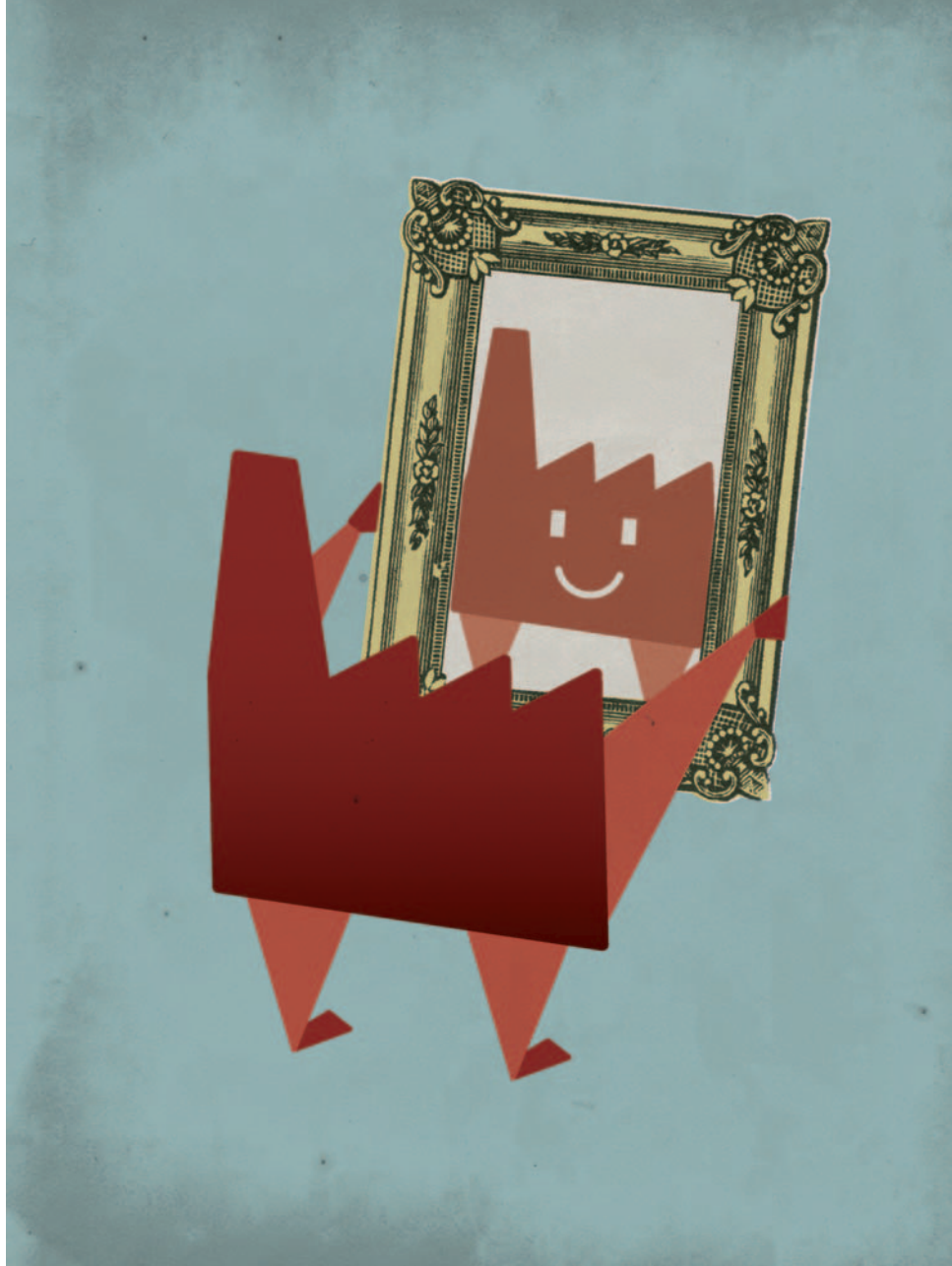
**• PROTECT AGAINST THIRD PARTY ACTIVITIES WHICH MAY IMPACT THE DUE DILIGENCE.**

It is important to realize that obtaining patents on your company's technology does not guarantee that technology does not infringe patents held by third parties.

Accordingly, in addition to looking at the intellectual property owned by the company, a prospective investor or partner will search for intellectual property that is held by others and which may encompass company activities. Should any come to light, it will become the focus of inquiry, so the company should be prepared to explain why such intellectual property is not problematic.

In this regard, it is helpful for the company itself to conduct such an analysis early in its lifetime, and from then on to regularly search for pertinent patents, both to ensure the company is free to commercialize its products, and to avoid surprises during due diligence.

A prospective investor or partner may conduct an active search for relevant third party activities, such as



publications or products on the market prior to the filing dates of your company's patents, which could cause the patents to be invalid. Again, it may be advisable for your company to conduct such an analysis on its core technologies early in its lifetime and periodically thereafter in order to avoid these issues during due diligence.

The company's licensing agreements with third parties also may contain provisions which restrict its ability to commercialize its technology. In particular, provisions that leave significant rights in the hands of other parties or that hamper the company's ability to sublicense its technology may negatively impact the due diligence. Accordingly, it is important to keep these considerations in mind at the time your company enters into licensing arrangements or partnerships.

By considering these third party relationships prior to due diligence, your company can avoid surprises during the process, with possibly significant obstacles to funding.

- **MAINTAIN THE ATTORNEY-CLIENT PRIVILEGE.**

Sometimes when performing the analysis of third-party patents, the target company will identify certain patents of potential concern. In response, the company should commission an outside attorney to analyze those patents to determine whether the company is or is not infringing, or whether those patents are invalid. Assuming a favorable outcome of the analysis, the outside attorney will prepare an opinion for the company.

Because that opinion is a communication from the attorney to the company, should litigation arise regarding these patents, the opinion itself and the underlying related materials are protected from discovery under the attorney-client privilege. Although maintaining the attorney-client privilege is in the interest of both the target company and the party performing the due diligence analysis, it is not uncommon for the party conducting due diligence to request copies of the opinions.

Since disclosure of the opinions may waive the privilege, it is important for the company to refrain from providing them. Instead, the company may suggest that the party conducting the due diligence hold a teleconference with the outside attorney, who will summarize the company's position regarding the patents. The outside attorney will know how to convey the company's position on the patents without waiving the privilege.

These are the basics. To increase the likelihood that your company will obtain the funding or partnerships necessary for growth and development, keep in mind the importance of intellectual property in the due diligence process, and with that in mind conduct an analysis of your company's intellectual property well before the due diligence process begins.



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